BANK OF CANADA
BANQUE DU CANADA

Monetary Policy Report

July 2024

Canada's inflation-control strategy

Inflation targeting and the economy

- The objective of Canada's monetary policy is to promote the economic and financial well-being of Canadians. Canada's experience with inflation targeting since 1991 has shown that the best way that monetary policy can achieve this goal is by maintaining a low and stable inflation environment. Doing so fosters confidence in the value of money and contributes to sustained economic growth, a strong and inclusive labour market and improved living standards.
- In 2021, the Government of Canada and the Bank of Canada renewed the flexible inflation-targeting strategy of the monetary policy framework for a further five-year period, ending December 31, 2026.[1]
- The inflation target was renewed at the 2% midpoint of the 1%–3% control range, with inflation measured as the 12-month rate of change in the consumer price index (CPI).
- The Government and the Bank agreed that the best contribution monetary policy can make to the economic and financial well-being of Canadians is to continue to focus on price stability. The Government and the Bank also agreed that monetary policy should continue to support maximum sustainable employment, recognizing that maximum sustainable employment is not directly measurable and is determined largely by non-monetary factors that can change through time.
- Further, the Government and the Bank agreed that because well-anchored inflation expectations are critical to achieving both price stability and maximum sustainable employment, the primary objective of monetary policy is to maintain low, stable inflation over time.

Inflation targeting is *symmetric* and *flexible*

- Canada's inflation-targeting approach is *symmetric*, which means the Bank is equally concerned about inflation rising above or falling below the 2% target.
- Canada's inflation-targeting approach is also *flexible*. Typically, the Bank seeks to return inflation to target over a horizon of six to eight quarters. However, the most appropriate horizon for returning inflation to target will vary depending on the nature and persistence of the shocks buffeting the economy.
- The 2021 agreement with the Government specifies that the 2% inflation target remains the cornerstone of the framework.
- The agreement further notes that the Bank will continue to use the flexibility of the 1%–3% control range to actively seek the maximum sustainable level of employment, when conditions warrant. The Bank will also continue to leverage the flexibility inherent in the framework to help address the challenges of structurally low interest rates by using a broad set of policy tools. The Bank will use this flexibility only to an extent that is consistent with keeping medium-term inflation expectations well anchored at 2%.

Monetary policy tools

- Because monetary policy actions take time to work their way through the economy and have their full effect on inflation, monetary policy must be forward-looking.
- The Bank normally carries out monetary policy through changes in the target for the overnight rate of interest (the policy rate). The Bank also has a range of monetary policy tools it can use when the policy rate is at very low levels. These tools consist of guidance on the future evolution of the policy rate, large-scale asset purchases (quantitative easing and credit easing), funding for credit measures, and negative policy rates. The potential use and sequencing of these tools would depend on the economic and financial market context.
- All of the Bank's monetary policy tools affect total demand for Canadian goods and services through their influence on market interest rates, domestic asset prices and the exchange rate. The balance between this demand and the economy's production capacity is, over time, the main factor that determines inflation pressures in the economy.

Communications

- Consistent with its commitment to clear, transparent communications, the Bank regularly reports its perspectives on the economy and inflation. Policy decisions are typically announced on eight pre-set days during the year with a press release followed by a press conference, and full updates to the Bank's outlook are published four times each year in the *Monetary Policy Report*.
- The Bank is committed to explaining when it is using the flexibility of the inflation-targeting strategy.
- Given the uncertainty about the maximum sustainable level of employment, the Bank will consider a broad range of labour market indicators. The Bank will also systematically report to Canadians on how labour market outcomes have factored into its policy decisions.

Monitoring inflation

- In the short run, the prices of certain CPI components can be particularly volatile and can cause sizable fluctuations in CPI inflation.
- In setting monetary policy, the Bank seeks to look through such transitory movements in CPI inflation and focuses on "core" inflation measures that better reflect the underlying trend of inflation. In this sense, these measures act as an operational guide to help the Bank achieve the CPI inflation target. They are not a replacement for CPI inflation.
- The Bank's two preferred measures of core inflation are CPI-trim, which excludes CPI components whose rates of change in a given month are the most extreme, and CPI-median, which corresponds to the price change located at the 50th percentile (in terms of basket weight) of the distribution of price changes.

1 For more details, see *Joint Statement of the Government of Canada and the Bank of Canada on the Renewal of the Monetary Policy Framework* (December 13, 2021); *Monetary Policy Framework Renewal—December 2021;* and T. Macklem, "Our Monetary Policy Framework: Continuity, Clarity and Commitment" (speech to the Empire Club of Canada, Toronto, December 15, 2021).

The *Monetary Policy Report* is available on the Bank of Canada's website at bankofcanada.ca.

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Monetary Policy Report

July 2024

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Contents

Overview

Consumer price index (CPI) inflation in Canada is moving closer to the 2% target as monetary policy works to reduce price pressures. Inflation is no longer broad-based, and measures of core inflation have eased significantly. However, some pressures remain, particularly in prices for services, and progress back to the target is expected to be uneven.

The global economy is expected to grow at around 3% over the projection horizon. In the United States, economic growth has slowed after a period of surprising strength. Past increases in interest rates are weighing on consumption, and government spending has moderated. The euro area economy, meanwhile, is expanding after stalling in 2023. Inflation remains above central bank targets in the United States and the euro area, though it is expected to gradually ease.

Economic growth in Canada has picked up but remains weak relative to population growth. Consumer spending per person has been declining, and residential investment has been subdued. Strong population growth has added to the supply of workers, and the labour market has cooled significantly.

Canada's economy is expected to strengthen in the second half of 2024. In the near term, growth in exports and household spending is anticipated to pick up. Household spending should strengthen further in 2025 as borrowing costs ease. Population growth is projected to slow because of new limits on arrivals of temporary residents. Excess supply will slowly be absorbed.

The ongoing excess supply in the economy is expected to pull inflation down. Other indicators of underlying price pressures also point to lower inflation going forward. Inflation expectations have generally fallen, and businesses appear to have resumed normal price-setting behaviour.

Wage growth, however, remains elevated, and inflation in services most affected by wages is proving persistent. Inflation in shelter prices also remains high, led by rent and mortgage interest costs.

Overall, core inflation is expected to ease to about 2.5% in the second half of 2024 and then continue its gradual decline. CPI inflation is forecast to fall below core inflation largely due to temporary downward pressure from gasoline prices. It is then projected to rise modestly into the first half of 2025, before returning sustainably to 2% in the second half of that year.

Global economy

The global economy is forecast to grow at around 3% over the projection horizon, in line with its current pace. This is broadly as expected in the April Report (**Table 1** and **Box 1**). US economic growth has slowed materially this year, while the euro area is recovering from a period of weakness.

Inflation is above central bank targets in both the United States and the euro area due to continued strong growth in services prices. As labour markets move into better balance, inflation should ease gradually.

Table 1: Projection for global economic growth

	Share of real global GDP* (%)	Projected growth† (%)			
		2023	2024	2025	2026
United States	16	2.5 (2.5)	2.3 (2.7)	2.1 (1.8)	2.2 (2.2)
Euro area	12	0.6 (0.5)	0.7 (0.4)	1.3 (1.2)	1.6 (1.7)
Japan	4	1.8 (1.9)	0.0 (0.8)	1.1 (0.7)	0.7 (0.5)
China	18	5.2 (5.2)	4.7 (4.7)	4.3 (4.4)	4.0 (3.9)
Oil-importing EMEs‡	34	3.9 (3.9)	3.9 (3.5)	3.8 (3.7)	3.9 (4.0)
Rest of the world§	16	1.4 (1.2)	1.8 (1.7)	2.5 (2.7)	2.5 (2.5)
World	100	3.1 (3.1)	2.9 (2.8)	3.0 (3.0)	3.0 (3.1)

* Shares of gross domestic product (GDP) are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2022 from the IMF's October 2023 *World Economic Outlook*. The individual shares may not add up to 100 due to rounding.

† Numbers in parentheses are projections used in the previous Report.

‡ The oil-importing emerging-market economies (EMEs) grouping excludes China. It is composed of large EMEs from Asia, Latin America, the Middle East, Europe and Africa (such as India, Brazil and South Africa) as well as newly industrialized economies (such as South Korea).

§ *Rest of the world* is a grouping of other economies not included in the first five regions. It is composed of oil-exporting EMEs (such as Russia, Nigeria and Saudi Arabia) and other advanced economies (such as Canada, the United Kingdom and Australia).

Sources: National sources via Haver Analytics and Bank of Canada calculations and projections

Box 1

Changes to the economic projection since the April Report

Global outlook

The outlook for global growth is broadly in line with that in the April Report, although, in the near term, the composition is somewhat different. The 2024 outlook for emerging-market economies (EMEs) and the euro area is stronger, while for the United States, the outlook for growth is weaker.

- EME growth has been revised up, reflecting stronger investment and exports.
- Euro area growth has been revised up due to an earlier-than-expected recovery in services activity.
- Growth in the United States has been revised down, partly because of lower household spending on consumption and residential investment.

Canadian outlook

The outlook for population growth in Canada has been revised up. Inflation is expected to continue easing broadly in line with the April Report.

- The changes to population are expected to add to both demand and supply and are roughly offsetting on the output gap. The growth rate of the working-age population is assumed to be roughly 0.2 percentage points higher in 2024 and about 0.6 percentage points higher in 2025–26 (**Box 2**).
- Growth in the first quarter of 2024 was roughly 1 percentage point lower than projected. This was in part the result of weaker-than-expected motor vehicle exports because the impacts of retooling were felt more quickly than anticipated. Residential investment was also below expectations, largely because of slower growth in new construction.
- The forecast for growth is roughly unchanged in 2025 and is revised up by one-half of a percentage point in 2026. The change in 2026 is due to upward revisions to the assumptions for population growth. Population growth is expected to decline, but not as quickly as previously forecast.
- In contrast, growth in gross domestic product per person is expected to be around three-quarters of a percentage point weaker in 2025 and roughly unchanged in 2026. Household spending is projected to be lower, in line with survey evidence that shows consumers remain cautious in the face of higher prices and interest rates. As a result, excess supply is expected to be slightly larger over the course of the projection horizon.

Consumer price index inflation came in 0.2 percentage points weaker than expected in the second quarter of 2024.

- Inflation in goods excluding food and energy has fallen faster than anticipated, moving more in line with input costs.
- In 2025, inflation is forecast to be 0.2 percentage points higher, due in part to stronger-than-expected effects of property tax increases. In 2026, inflation is projected to be 0.1 percentage point lower relative to the April Report.
- In contrast, core inflation is 0.1 percentage point lower in 2025 and 2026, reflecting slightly greater excess supply over the projection.

Slow US growth

US growth is expected to have slowed significantly to an average of 1½% over the first half of 2024, down from about 4% in the second half of 2023.

Moderating growth in consumption and government spending has contributed to the slower pace of economic expansion. Consumption growth eased from an average of more than 3% in the second half of 2023 to about 1½% in the first half of 2024. This largely reflects the effects of past increases in interest rates, which raised borrowing costs. Consumer credit growth has slowed, and credit card delinquencies and loans in arrears are rising.

Government spending growth also eased in the first half of 2024. This mainly reflects a smaller impact from US federal government incentives on infrastructure spending as well as legislative constraints that held back growth in federal discretionary spending.

Growth in gross domestic product (GDP) is expected to gradually increase in the second half of 2024 to around 2% as growth in exports and consumption picks up. However, some uncertainty surrounds the strength of this increase.

In the projection, growth settles at a pace just over 2% in 2025 and 2026. This is broadly in line with the outlook for growth in potential output. Growth in consumption spending should pick up in 2026 in response to lower interest rates. This is partially offset by the projected slowdown in business investment growth, which is occurring due to the fading boost from various government incentives. Government spending growth is expected to continue to moderate in the second half of 2024 and remain weak thereafter.

US inflation above target

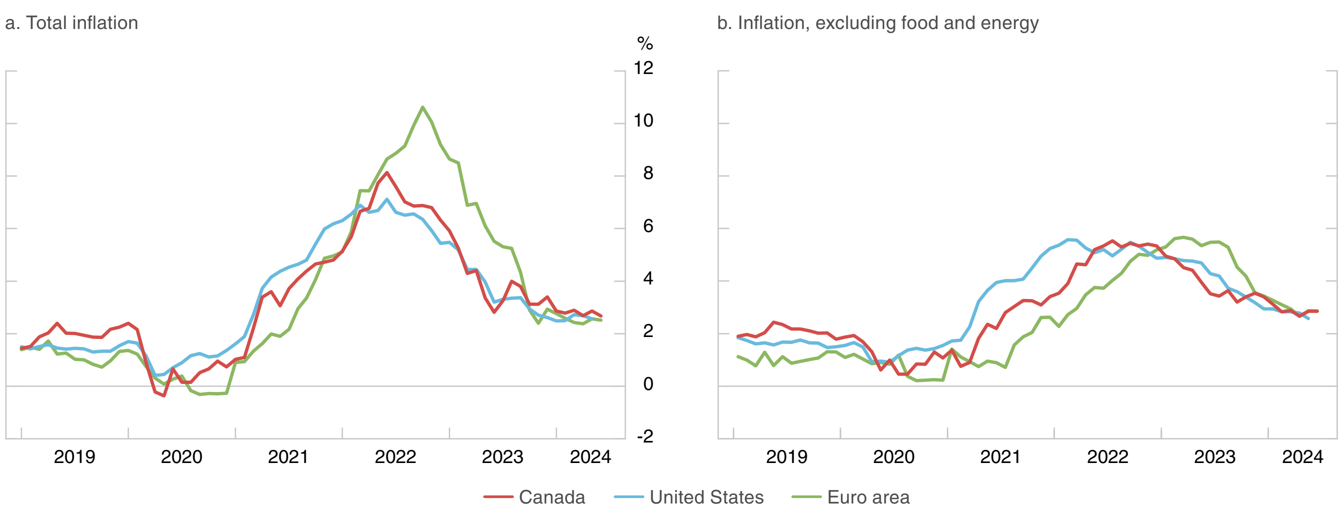
US inflation has eased (**Chart 1**) but remains above the Federal Reserve's 2% target. Strong growth in services prices is keeping US inflation above target even though inflation in goods prices has returned to close to zero percent—near its historical average (**Box 4**, page 18).

The strength in services price inflation reflects two factors:

- Inflation components that use long-term price contracts—such as rental housing and motor vehicle insurance—are adjusting slowly and their prices continue to rise in response to past inflationary pressures.
- Increases in the prices of some volatile components of the services sector, such as financial services, were relatively strong during the first half of the year.

Chart 1: Inflation is still above central bank targets

Year-over-year percentage change, monthly data



Note: Inflation rate calculations are based on the Harmonised Index of Consumer Prices for the euro area, the personal consumption expenditures price index for the United States and the consumer price index for Canada.

Sources: Statistics Canada, US Bureau of Economic Analysis and Eurostat via Haver Analytics and Bank of Canada calculations

Last observations: United States, May 2024; others, June 2024

US inflation is projected to ease gradually in the coming quarters as inflation in services prices moderates. The ongoing easing in the labour market should help reduce cost pressures. Shelter price inflation continues to moderate. This mostly reflects slower growth in the prices of new rental contracts that are gradually feeding into official inflation measures. Overall, with demand now broadly balanced with supply and the economy growing at a more measured pace, conditions are consistent with inflation gradually returning to the Federal Reserve's 2% target.

Return to growth in the euro area

Economic activity in the euro area is expected to have grown at an annualized pace of just above 1% over the first half of 2024, after having stalled in the second half of 2023. A services-led recovery is now underway, while past energy shocks and disruptions continue to weigh on the manufacturing sector. Over the projection, growth is forecast to slowly rise to around 1½% in 2026, supported by a resilient labour market, rising real income and a gradual decline in interest rates.

Inflation in the euro area has been around 2½% recently. Remaining inflationary pressures are mostly in services. Much of this upward pressure is from components related to tourism, such as hotel accommodation and restaurant services.

Inflation is expected to remain at close to its current pace over coming quarters. This partly reflects ongoing strength in wage growth and strong demand for services. In addition, the temporary impact on prices stemming from strong demand related to some cultural and sporting events, such as the Paris Olympics, is expected to help keep inflation elevated. Inflation should gradually abate starting in 2025 as these one-off factors fade. Inflation then continues to ease toward the European Central Bank's target because real interest rates remain restrictive. This maintains a modest degree of excess supply, which will help reduce pressures from labour costs.

Slowdown in China's export-led growth

Growth in China has been modest in recent quarters, led by broad-based growth in exports. The prices of China's exports have dropped, which has fuelled foreign demand. In contrast, growth in domestic demand has been weak. Deleveraging in the property sector has restrained investment, while falling prices for housing have weighed on consumer confidence.

In the projection, China's growth is expected to slow as export growth moderates. This slowdown in exports is partially offset by policy support for infrastructure spending.

Elsewhere in emerging Asia, growth is supported by an ongoing recovery in tourism and exports. Growth in emerging-market economies (EMEs) is projected to continue at or close to its current pace until the end of 2026.

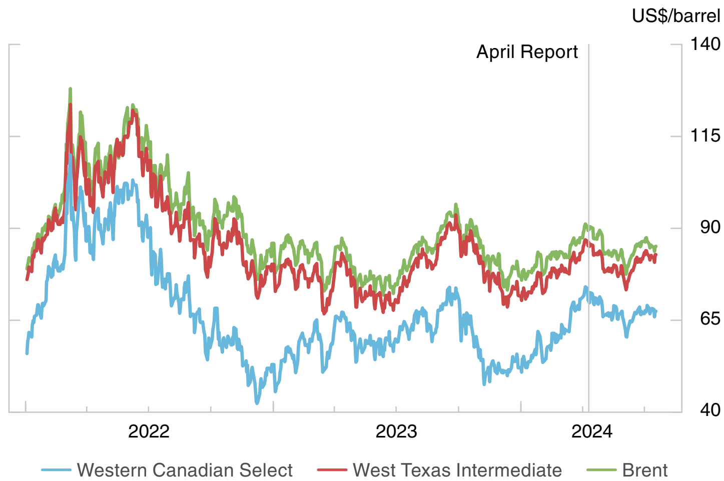
Global oil prices unchanged

The price of Brent oil has fluctuated around US$85—the level assumed in both the April Report and the current projection (**Chart 2** and **Box 2**). In response to weaker-than-expected demand, members of the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC oil producers have extended production cuts until at least the end of the summer. In Canada, the start-up of the Trans Mountain Expansion pipeline has helped narrow the spread between West Texas Intermediate and Western Canadian Select oil prices from its 2022–23 average of close to US$20 to near US$15.

Relative to the April Report, the Bank's non-energy commodity price index is modestly lower. Lumber prices have been weaker due to the recent slowing in US residential construction. Base metals and agricultural prices are somewhat weaker.

Chart 2: Oil prices are roughly unchanged from the April Report

Daily data



Sources: Kalibrate Canada Inc., NYMEX and Intercontinental Exchange via Haver Analytics
Last observation: July 18, 2024

Box 2

Key inputs to the projection

The Bank of Canada's projection is conditional on several key inputs and assumptions about their future path. The Bank regularly reviews these assumptions and adjusts the economic projection accordingly.

Population growth

At the time of the April Report, population growth of people aged 15 and older was assumed to slow from 3.3% in the first half of 2024 to 1.0% on average over 2025 and 2026. The path incorporated a sharp decrease in net inflows of non-permanent residents (NPRs) beginning in the second half of 2024.[1] On March 21, 2024, the federal government announced plans to reduce net inflows of NPRs to lower their share of the total population from 6.2% to 5% within three years. Overall, this implied that the annual population growth rate would decline by about 2 percentage points in 2025 and 2026.

NPRs represented 6.8% of the population at the beginning of April—much higher than at the time of the March announcement—and the share is expected to continue rising over the near term. This suggests that it will take longer for planned policies to reduce NPR inflows to achieve the 5% target (**Chart 2-A**). Overall, population growth of people aged 15 and older is now assumed to be 3.3% in 2024 and 1.7% in 2025–26. Compared with the April Report, this is higher by 0.2 percentage points in 2024, 0.7 percentage points in 2025 and 0.6 percentage points in 2026.

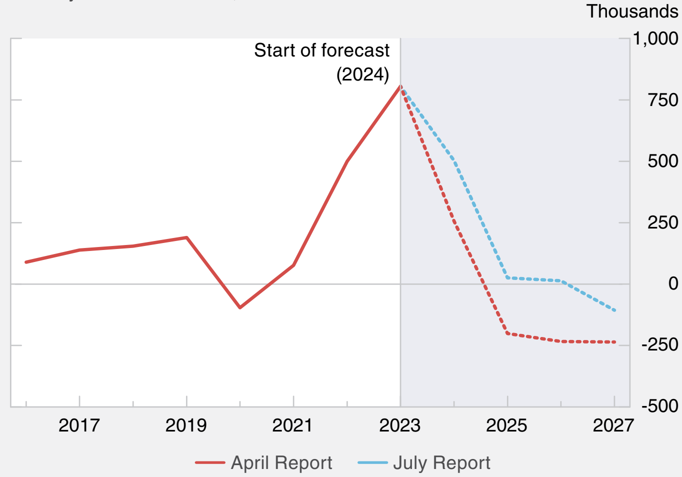
Considerable uncertainty continues to surround the future path of net NPR flows.[2] Details on how most temporary resident permit programs will be adjusted are not expected until later this year. The Bank's scenario will be revised as further measures are announced and more details on program changes become available.

1 NPRs include temporary foreign workers, international students and asylum seekers.

2 If NPRs continue to either leave Canada or become permanent residents at rates observed since 2021, achieving the target would require reducing average annual gross inflows by around 70% to 80% across multiple programs over the next three years. These programs include the temporary foreign workers program, the international mobility program and asylum seeker programs. The reductions would be in addition to those coming from the cap on the number of international students and the expiry of the Canada–Ukraine authorization for emergency travel program.

Chart 2-A: Net flows of non-permanent residents have been revised up over the projection

January 1 to December 31, annual data



Sources: Immigration, Refugees and Citizenship Canada; Statistics Canada; and Bank of Canada calculations

Other key inputs

The other key inputs to the Bank's projection are as follows:

- Potential output growth in Canada is expected to slow from about 2.4% in 2024 to around 1.9% on average over 2025 and 2026. Relative to the April Report, potential output growth has been revised down by 0.1 percentage point in 2024. It has been revised up by 0.1 percentage point in 2025 and 0.5 percentage points in 2026.
  - Population growth of persons aged 15 and older is revised up by 0.2 percentage points in 2024, 0.7 percentage points in 2025 and 0.6 percentage points in 2026.
  - This is offset by downward revisions to trend labour productivity growth averaging 0.4 percentage points in 2024 and 2025. This downward revision partly reflects the constraints on housing construction coming from structural factors, such as the availability of land, zoning restrictions and a lack of skilled labour.

(*continued…*)

Box 2 (*continued*)

- Growth in real gross domestic product is estimated to be about 1.5% in the second quarter of 2024. As a result, the Bank estimates that the output gap is between -0.75% and -1.75% in the second quarter, roughly unchanged from its estimated level in the first quarter of 2024.[3]
- The projection incorporates information from provincial and federal budgets that have been tabled at the time of writing.
- Over the projection horizon, the per-barrel prices for oil in US dollars are assumed to be $85 for Brent, $80 for West Texas Intermediate and $65 for Western Canadian Select. These prices are the same as in the April Report.

3 The output gap for the first quarter of 2024 was revised to be 0.2 percentage points wider, reflecting weaker-than-expected growth.

- By convention, the Bank does not forecast the exchange rate in the *Monetary Policy Report*. The Canadian dollar is assumed to remain at 73 cents US over the projection horizon, close to its recent average and 1 cent lower than the assumption in the April Report.
- The nominal neutral interest rate in Canada is estimated to be in the range of 2¼% to 3¼%, unchanged from the April Report. The nominal neutral interest rate is defined as the real neutral rate plus 2% for inflation. The economic projection assumes that the neutral rate is at the midpoint of this range. The real neutral rate is the rate to which the policy rate would converge in the long run, when output is sustainably at its potential and inflation is at target (i.e., after all cyclical shocks have dissipated). It is a medium- to long-term equilibrium concept.

Easing financial conditions

Global financial conditions have eased since the April Report. US equity prices have continued to rise, particularly in the technology sector. US bond yields have moved down due to softer economic data and expectations that the Federal Reserve will soon cut interest rates. Corporate credit spreads are at historically narrow levels and corporate debt issuance has been robust.

Canadian bond yields have also fallen since the April Report. The decline in these yields reflects two main factors:

- Canadian economic data were softer than markets had expected.
- Policy rates implied by the overnight index swap markets shifted down after the Bank's policy rate cut in June.

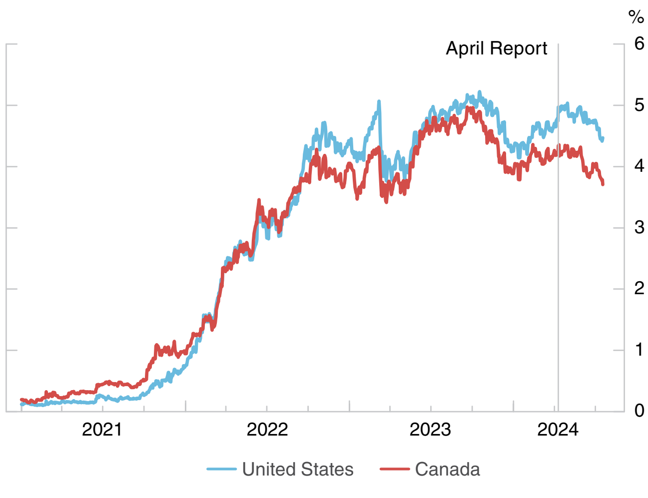
The yield on a Canadian two-year government bond is now close to 80 basis points lower than its US counterpart (**Chart 3**).

The value of the Canadian dollar is roughly unchanged against the US dollar at about 73 cents US.

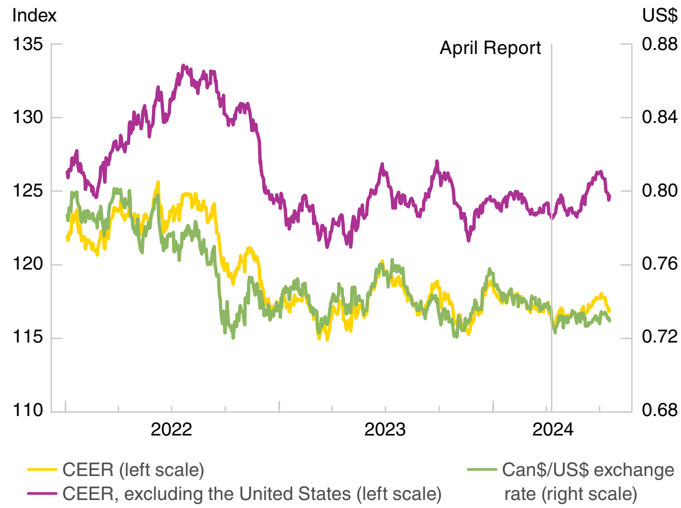
Chart 3: Since the April Report, global financial conditions have eased, while the Canadian dollar has remained stable

Daily data

a. Two-year government bond yield



b. Canadian exchange rates



Note: CEER is the Canadian Effective Exchange Rate index—a weighted average of bilateral exchange rates for the Canadian dollar against the currencies of Canada's major trading partners.

Sources: Bloomberg Finance L.P. and Bank of Canada calculations

Last observation: July 18, 2024

Canadian economy

Inflation has come down from 3.4% in December 2023 to 2.7% in June 2024. Broad inflationary pressures have been easing. Measures of core inflation declined from roughly 3½% to 2¾% over the same period, and the share of prices rising more than 3% is now close to its historical average. But price pressures remain in shelter and some services excluding shelter.

After having stalled in the second half of 2023, GDP expanded by roughly 1¾% in the first quarter of 2024 (**Table 2** and **Table 3**). This was driven by strong population growth. However, on a per-person basis, GDP contracted for the fourth consecutive quarter due to ongoing weak household spending. Slack has opened up across certain segments of the labour market, and there is more excess supply in the economy.

Economic growth is forecast to increase in the second half of 2024 and beyond as interest rates gradually ease and both household and business confidence rise. Growth in GDP per person is expected to increase gradually over 2025 and to reach 1% in 2026. At the same time, population growth is assumed to slow over this period. Overall, GDP growth is anticipated to be about 2% in 2025 and 2½% in 2026.

Table 2: Contributions to average annual real GDP growth
Percentage points*†

	2023	2024	2025	2026
Consumption	0.9 (0.9)	1.1 (0.6)	0.7 (0.8)	1.4 (1.1)
Housing	-0.9 (-0.9)	0.1 (0.4)	0.5 (0.6)	0.5 (0.5)
Government	0.5 (0.5)	0.6 (0.7)	0.7 (0.7)	0.4 (0.4)
Business fixed investment	-0.1 (-0.1)	-0.1 (0.0)	0.4 (0.3)	0.5 (0.2)
Subtotal: final domestic demand	0.5 (0.5)	1.7 (1.7)	2.3 (2.4)	2.8 (2.2)
Exports	1.8 (1.9)	0.6 (1.0)	1.2 (1.1)	0.7 (0.4)
Imports	-0.3 (-0.3)	-0.4 (-0.6)	-1.0 (-1.0)	-0.9 (-0.6)
Inventories	-0.8 (-1.0)	-0.7 (-0.6)	-0.4 (-0.3)	-0.2 (-0.1)
GDP	1.2 (1.1)	1.2 (1.5)	2.1 (2.2)	2.4 (1.9)
Memo items (percentage change):				
Range for potential output	1.4–3.2 (1.4–3.2)	2.1–2.8 (2.1–2.8)	1.1–2.4 (1.1–2.4)	0.9–2.2 (0.9–2.2)
Real gross domestic income (GDI)	-0.9 (-1.0)	1.1 (1.4)	0.7 (0.7)	2.0 (1.6)
CPI inflation	3.9 (3.9)	2.6 (2.6)	2.4 (2.2)	2.0 (2.1)

* Numbers in parentheses are from the projection in the previous Report.
† Numbers may not add to total due to rounding.
Sources: Statistics Canada and Bank of Canada calculations and projections

Table 3: Summary of the quarterly projection for Canada*

	2023	2024				2024	2025	2026
	Q4	Q1	Q2	Q3		Q4	Q4	Q4
CPI inflation (year-over-year percentage change)	3.3 (3.3)	2.8 (2.8)	2.7 (2.9)	2.3		2.4 (2.2)	2.0 (2.1)	2.0 (2.1)
Core inflation (year-over-year percentage change)†	3.4 (3.5)	3.1 (3.3)	2.7 (3.0)	2.5		2.4	2.0	2.0
Real GDP (year-over-year percentage change)	1.0 (0.9)	0.5 (1.0)	0.7 (1.2)	1.5		2.0 (2.1)	2.1 (2.2)	2.5 (1.9)
Real GDP (quarter-over-quarter percentage change at annual rates)‡	0.1 (1.0)	1.7 (2.8)	1.5 (1.5)	2.8				

* Details on the key inputs to the base-case projection are provided in **Box 2**. Numbers in parentheses are from the projection in the previous Report.

† Core inflation is the average of CPI-trim and CPI-median.

‡ Over the projection horizon, 2024Q2 and 2024Q3 are the only quarters for which some information about real GDP growth was available at the time the projection was conducted. For longer horizons, fourth-quarter-over-fourth-quarter percentage changes are presented. They show the Bank's projected growth rates of CPI and real GDP within a given year. As such, they can differ from the growth rates of annual averages shown in **Table 2**.

Sources: Statistics Canada and Bank of Canada calculations and projections

Potential output growth is projected to slow from roughly 2¼% in 2024 to a more modest average of 2% over 2025 and 2026. This moderation reflects expected changes in the inflow of non-permanent residents. Growth in trend labour productivity is forecast to turn positive in 2025 and expand further in 2026.

In the second half of 2024, core inflation is projected to ease to about 2.5%. Meanwhile, CPI inflation will fall below core inflation, in part due to base-year effects on gasoline prices. By the first half of 2025, this effect will have faded and CPI inflation is expected to rise modestly. Inflation then settles sustainably at 2% in the second half of 2025.

Over much of the projection horizon, housing market imbalances and labour cost growth are expected to continue to put upward pressure on services price inflation. This is being offset by moderate excess supply, which is exerting broad-based downward pressure on inflation. By the end of the projection, these pressures fade.

Modest GDP growth

GDP is on track to expand by 1½% in the second quarter of 2024 (**Chart 4**). With Canada's population growing at about 3%, this implies GDP per person is expected to contract by about 1½%, similar to its pace in the first quarter of the year. This decline is mainly due to a significant reduction in consumption per person because:

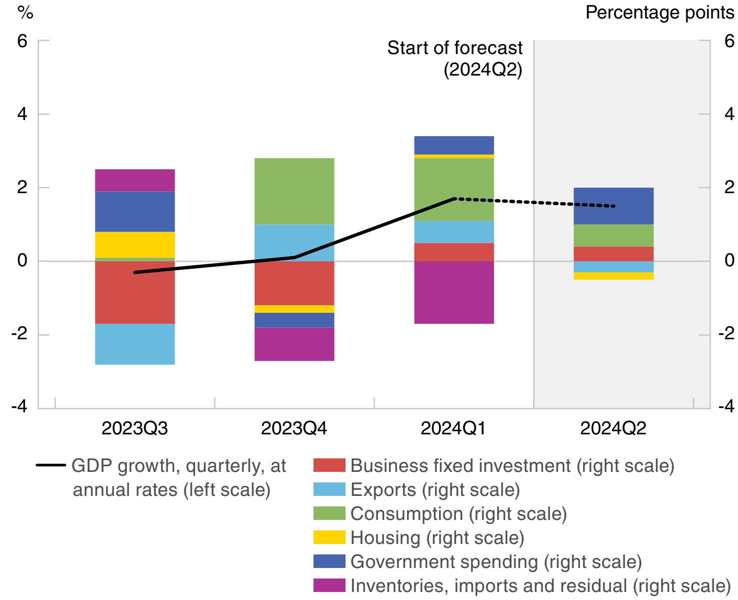
- Demand for both motor vehicles and travel abroad is slowing as pandemic-related pent-up demand fades (**Chart 5**).
- Households are allocating a larger share of their income to servicing debt payments, leaving less to spend on discretionary items such as meals at restaurants and clothing and footwear.

Residential investment also looks to be weak, falling 2½% in the quarter. This reflects a slow spring resale market and weaker renovation spending mainly due to still-high interest rates.

In contrast, growth in government spending is projected to pick up. Business investment growth is on track to expand by 3½%, largely due to strong oil and gas drilling activity.

Chart 4: Real GDP is expected to expand by 1.5% in the second quarter of 2024

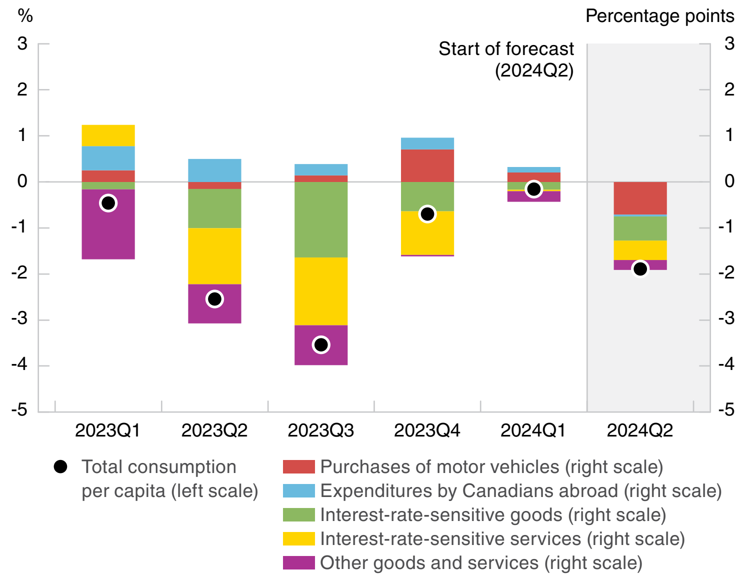
Contribution to real GDP growth, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

Chart 5: Growth of consumption per person continues to be weak

Contribution to real consumption per capita growth (aged 15 and older), quarterly data



Note: Data for the population aged 15 and older are from Statistics Canada's quarterly estimates of the population. For more information about what is included in the consumption categories, see T. Chernis and C. Luu, "Disaggregating Household Sensitivity to Monetary Policy by Expenditure Category," Bank of Canada Staff Analytical Note No. 2018-32 (October 2018).

Sources: Statistics Canada and Bank of Canada calculations

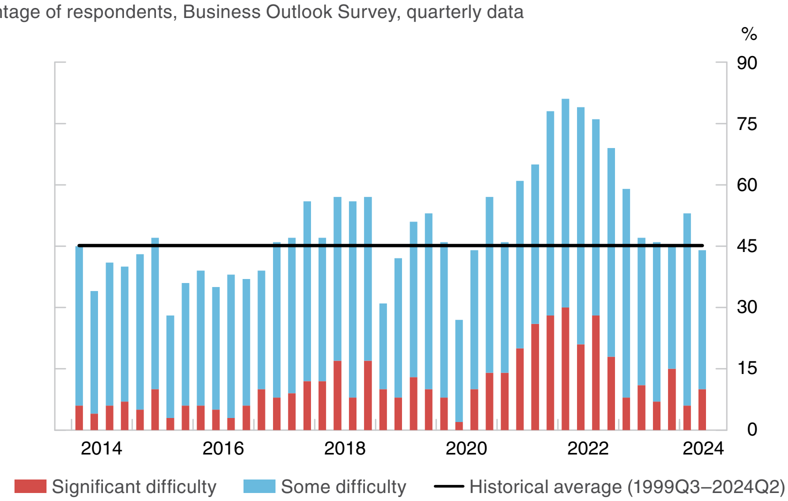
Ongoing excess supply

The economy has moved from excess demand in 2022 to excess supply. In the second quarter of 2024, the output gap is estimated to be between -0.75% and -1.75%. Businesses' reported capacity constraints have also fallen from their 2022 peak (**Chart 6**).

After a period of being overheated, the labour market has cooled significantly. Much of the easing has occurred through a fall in job vacancies, which are now near their historical average, and a much lower job finding rate (**Chart 7**). The unemployment rate has climbed from a low of about 5% in 2022 to 6.4% in June 2024, with youth and newcomers particularly impacted (**Box 3**).

Chart 6: Capacity pressures for businesses have eased since 2022

Percentage of respondents, Business Outlook Survey, quarterly data



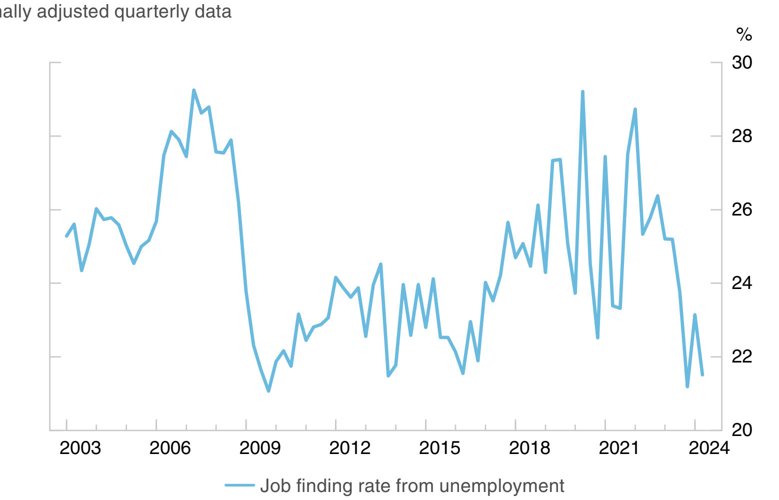
Note: This chart shows the percentage of respondents to the Business Outlook Survey reporting some or significant difficulty meeting an unexpected increase in demand or sales.

Source: Bank of Canada

Last observation: 2024Q2

Chart 7: The job finding rate has slowed

Seasonally adjusted quarterly data



Note: *Job finding rate from unemployment* is calculated by dividing the number of workers who transitioned from unemployment to employment by the total number of unemployed workers in the previous month.

Sources: Statistics Canada and Bank of Canada calculations

Last observation: 2024Q2

Box 3

Assessing the impacts of newcomers on the Canadian economy and inflation

Canada's total population has grown by 2.3 million (or 6%) over the past two years, with almost all this due to the arrival of newcomers (**Chart 3-A**).[1] The increased number of newcomers affects the economy through three main channels: labour markets, consumption and housing.

Labour markets

Adding newcomers to Canada's labour supply has significantly boosted the economy's potential for non-inflationary growth. For example, between the third quarter of 2022 and the first quarter of 2024, newcomer arrivals are estimated to have added 2½% to the level of potential output.

Many newcomers, however, face significant challenges integrating into the Canadian labour market.[2] In particular, the softening of the labour market has made it even harder for newcomers to find a job and be attached to the labour force (**Chart 3-B**). Difficulty getting foreign credentials and experience recognized in Canada also often results in newcomers taking jobs where their skills do not match those that are required for the position. This potential mismatch also weighs on productivity.

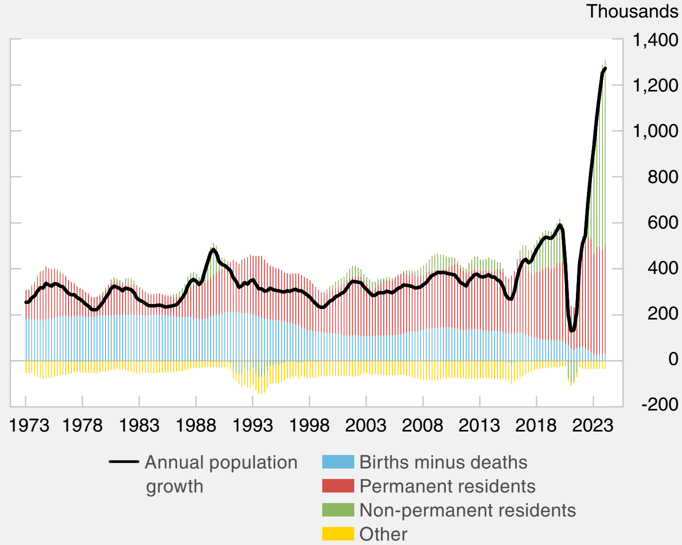
As a result, the boost to labour supply due to the arrival of newcomers could be initially somewhat lower than what would be expected given the increase in the working-age population.[3]

Consumption

While it may take some time for newcomers to add to aggregate supply, their impact on demand starts right away. Upon arrival, immigrants expect to spend substantially more than non-immigrants. Many newcomers bring substantial savings to set up households. This initial boost to demand can take place well before many newcomers have found employment.

Chart 3-A: Newcomers are boosting Canada's population growth

Contribution to annual population changes, quarterly data



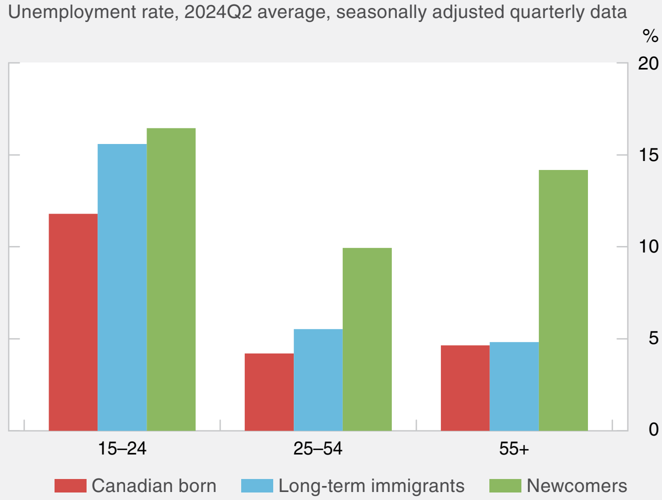
Note: *Non-permanent residents* includes temporary foreign workers, international students and asylum seekers. *Other* includes minor flows such as emigrants and returning emigrants.

Sources: Statistics Canada and Bank of Canada calculations

Last observation: 2024Q1

Chart 3-B: Newcomers are more likely than others to be unemployed across all working-age groups

Unemployment rate, 2024Q2 average, seasonally adjusted quarterly data



Note: *Newcomers* are non-permanent residents and immigrants who landed within the past five years.

Sources: Statistics Canada and Bank of Canada calculations

Last observation: 2024Q2

1 Newcomers are non-permanent residents and immigrants who arrived within the past five years. Immigrants are permanent residents and naturalized citizens.

2 For more details, see J. Champagne, E. Ens, X. Guo, O. Kostyshyna, A. Lam, C. Luu, S. Miller, P. Sabourin, J. Slive, T. Taskin, J. Trujillo and S. Wee, "Assessing the effects of higher immigration on the Canadian economy and inflation," Bank of Canada Staff Analytical Note No. 2023-17 (December 2023).

3 For more details, see **Box 2** of T. Devakos, C. Hajzler, S. Houle, C. Johnston, A. Poulin-Moore, R. Rautu and T. Taskin, "Potential output in Canada: 2024 assessment," Bank of Canada Staff Analytical Note No. 2024-11 (April 2024).

(*continued…*)

Box 3 (*continued*)

Overall, the consumption and employment profiles of newcomers suggest that they contribute slightly more to demand than to supply in the first few years after they arrive in Canada.

Housing

Strong population growth in recent years has boosted demand for housing. This is adding to existing pressures on house prices and rents.

The increase in housing demand from newcomers is being felt across all types of housing, but the largest initial impact tends to be in rental markets. This is because most newcomers start out as renters. Survey results indicate that immigrants are less likely to report owning a home until about 10 years after arriving in Canada (**Chart 3-C**).

Growth in housing supply has not kept up with the strong increase in demand, with construction activity remaining close to pre-pandemic levels. Long-standing structural challenges to faster growth in supply include:

- municipal zoning restrictions
- high development fees
- time-consuming and expensive permitting processes
- shortages of skilled construction workers

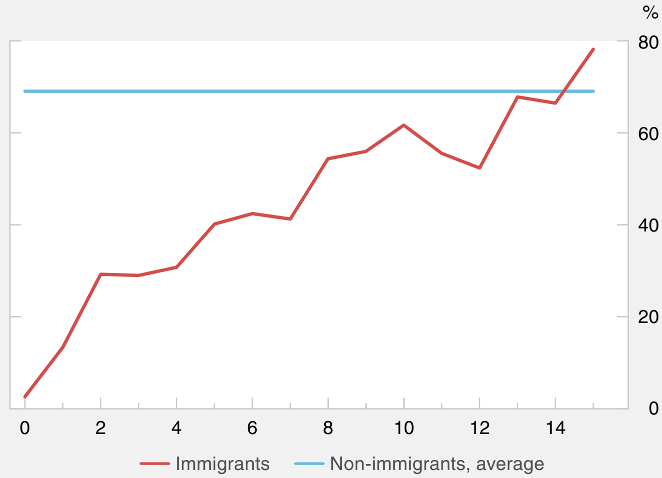
In the current environment, developers have also reported additional challenges due to high funding and construction costs.

Summary

The effects on overall supply and demand from increased population growth are expected to largely offset each other over the medium term. However, because newcomers affect demand sooner than supply, this unevenness contributes to inflationary pressures in some sectors. In particular, there are additional upward pressures on house prices and rents.

Chart 3-C: Home ownership rates among immigrants by years since arrival

Quarterly data



Note: This chart shows the percentage of respondents to the Canadian Survey of Consumer Expectations reporting they own a home by the number of years since their arrival in Canada. Results include data from the third quarter of 2021 to the second quarter of 2024. Non-permanent residents are excluded.

Source: Bank of Canada

Last observation: 2024Q2

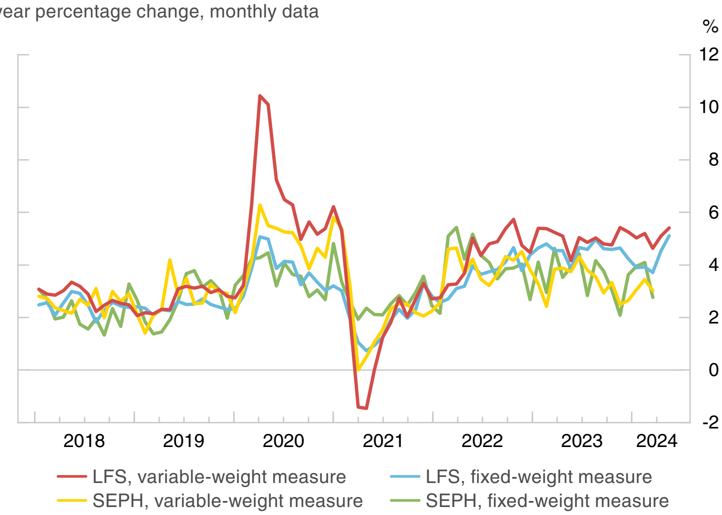
The unemployment rates for newcomers and youth have risen to 11.6% and 13.5%, respectively, from lows of 6.9% and 9.3% in 2022. Given the greater challenges in finding work, the participation rate for youth has fallen. In contrast, the increase in the unemployment rate for prime-age workers has been more muted, rising from 3.9% to 5.3% over the same period. Overall, the labour market has moved into excess supply.

Various measures of wage growth are sending mixed signals, and there are some signs of moderation (**Chart 8**). Nonetheless, wage growth remains elevated relative to productivity growth.

With the job vacancy rate now back to normal levels, further weakness in employment growth is likely to show up in higher unemployment rather than lower job vacancies.

Chart 8: Wage growth remains elevated

Year-over-year percentage change, monthly data



Note: LFS is the Labour Force Survey; SEPH is the Survey of Employment, Payrolls and Hours. The LFS fixed-weight measure is constructed using 2019 employment weights.

Sources: Statistics Canada and Bank of Canada calculations

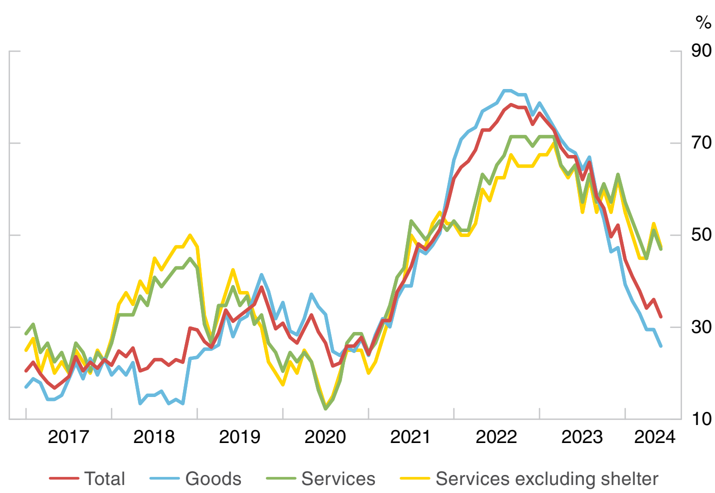
Last observations: LFS, June 2024; SEPH, April 2024

Slowing inflation

CPI inflation has come down from 3.4% in December to 2.7% in June (**Figure 1**). The easing reflects diverging developments in goods and services inflation. Goods inflation has fallen from 2.4% to 0.3%, while services inflation has increased from 4.3% to 4.8%. The share of goods prices rising by more than 3% is now at 26%, below its historical average of 28%. In contrast, the share of services prices rising by more than 3% is 47%, higher than its historical average of 35% (**Chart 9**).

Chart 9: Inflation in services prices is still more broad-based than normal

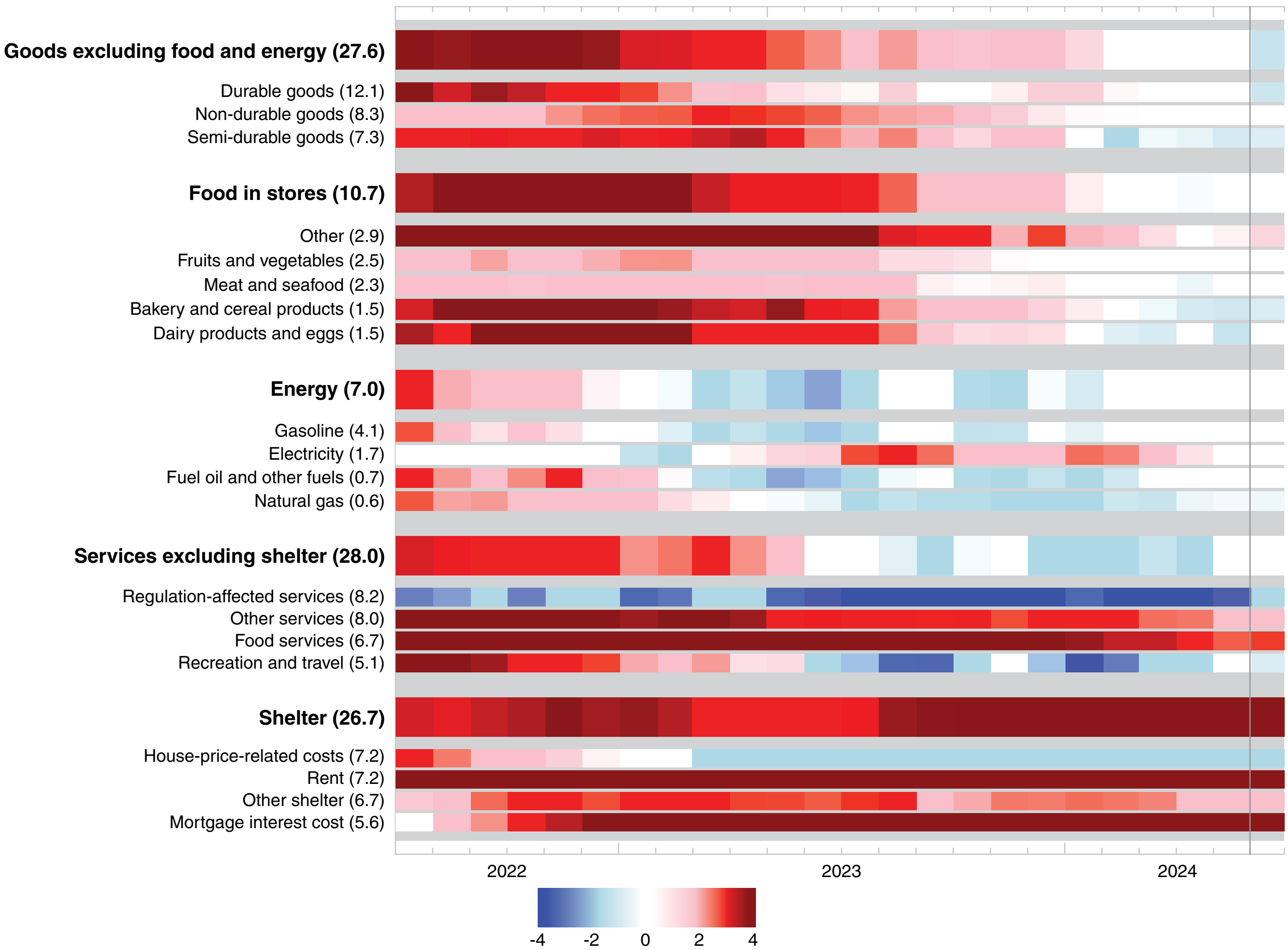
Share of CPI components with price growth above 3% over the past 12 months, monthly data



Sources: Statistics Canada and Bank of Canada calculations

Last observation: June 2024

Figure 1: CPI inflation has eased, although some components are persistently high



The heatmap shows the distance of each CPI component's year-over-year inflation rate from its historical average. The colour is white when a component's inflation rate is close to its average, and is a varying shade of red (blue) when the rate is above (below) the average. Because the historical range of inflation varies widely across CPI components, each inflation rate plotted in the heatmap is standardized by subtracting its mean and dividing by its standard deviation. This standardization is conducted using data from 1996–2019, except for *Regulation-affected services* and *Other services*, where available data begin in 2004 and 2008, respectively. Note that *Regulation-affected services* includes prices that are affected by government regulations either directly (e.g., child care services) or indirectly (e.g., telephone services). Values in parentheses are CPI weights (in percent). Due to rounding, weights within categories may not sum to their respective totals.

Last observation: June 2024

The decline in goods price inflation has been in non-energy goods. It reflects a fall in costs—such as import prices and past shipping costs—as well as slowing domestic demand (**Box 4**).

Elevated services price inflation reflects developments in both shelter price inflation and inflation in services excluding shelter. Shelter services price inflation is around 7%, near its level in December 2023 and well above its historical average. Rent inflation has risen from just below 8% to close to 9%. The pressure on rental prices has been amplified by strong population growth in the context of structural supply constraints. Inflation in mortgage interest costs remains very high but has eased somewhat since the beginning of 2024.

Box 4

Drivers of inflation in goods excluding energy and in services excluding shelter

Examining the factors behind recent changes in inflation in prices for core goods and services can provide insights into where inflation may be headed, at least over the near term.

Inflation in the prices of goods excluding energy has fallen from its peak of 7.2% in September 2022 to 0.3% in June, which is below its historical average. In contrast, inflation in services prices excluding shelter has moved up recently and is close to its historical average.

Goods excluding energy

Inflation in the prices of goods excluding energy has fallen sharply across many economies. Lower input costs have been a key driver of this decline, including in Canada.[1]

Input costs picked up strongly over 2021 due to factors such as pandemic-related supply disruptions, weather events and high energy prices. Food inflation picked up soon thereafter. After peaking in mid-2022, these cost pressures began to dissipate, and food inflation has fallen steadily (**Chart 4-A**).

Inflation in goods excluding food and energy has also fallen significantly, declining from its peak of 5.8% in June 2022 to -0.5% in June 2024. This decline has been broad-based. All major categories have seen large decreases in inflation, and most have had outright price reductions from recent highs.

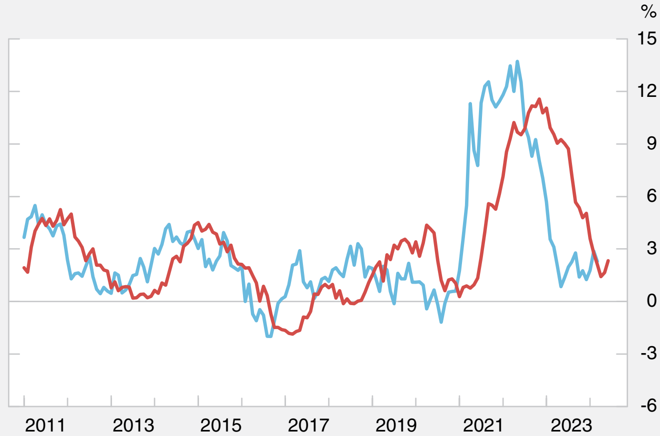
Lower costs have been a major factor. In particular, shipping costs and energy prices declined after rising sharply in 2021 due to pandemic-related supply disruptions. Inflation rates have also declined notably for many imported finished goods, such as clothing, and intermediate goods, such as plastic and chemicals.

Moreover, because consumer spending on many goods excluding food and energy is discretionary in nature, softer domestic demand has also contributed to the decline in inflation. This weakness in discretionary spending is consistent with evidence from the Canadian Survey of Consumer Expectations and the Business Outlook Survey.

1 Input costs are estimated as a weighted average of the costs incurred as part of the supply chain, including imports, production, transportation and labour.

Chart 4-A: Food price inflation has been falling in line with input costs

Year-over-year percentage change, monthly data



Note: *Food input costs* are estimated as a weighted average of the costs incurred as part of the food supply chain, including imports, production, transportation and labour.

Sources: Statistics Canada and Bank of Canada calculations

Last observations: food input costs, March 2024; food price inflation, June 2024

Services excluding shelter

Services excluding shelter inflation in Canada was 2.9% in June, close to its historical average. This is lower than the levels observed in the United States and the euro area, which have remained around 4% to 5% (**Chart 4-B**).

In Canada, for much of the past year, inflation in services excluding shelter was running around 2%, well below its historical average. This weakness reflected a combination of factors, including the emergence of excess supply and an unusually steep decline in communications prices.

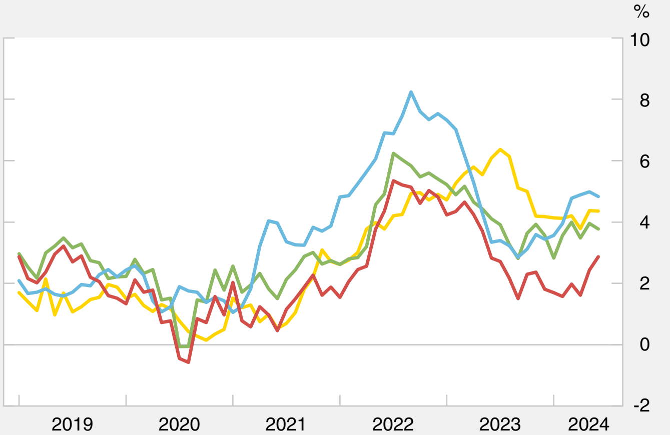
However, inflation in prices for services excluding shelter has picked up in recent months as the pace of price declines from communications has eased. In fact, if communications prices were removed from services excluding shelter, inflation for this category would be 3.8% (**Chart 4-B**). This may suggest that there is more underlying inflationary pressure in this category.

(*continued…*)

Box 4 (*continued*)

Chart 4-B: Inflation in services excluding shelter is lower in Canada

Year-over-year percentage change, monthly data



Note: Inflation rate calculations are based on the Harmonised Index of Consumer Prices for the euro area and the consumer price index for Canada and the United States.

Sources: Statistics Canada, US Bureau of Labor Statistics and Eurostat via Haver Analytics

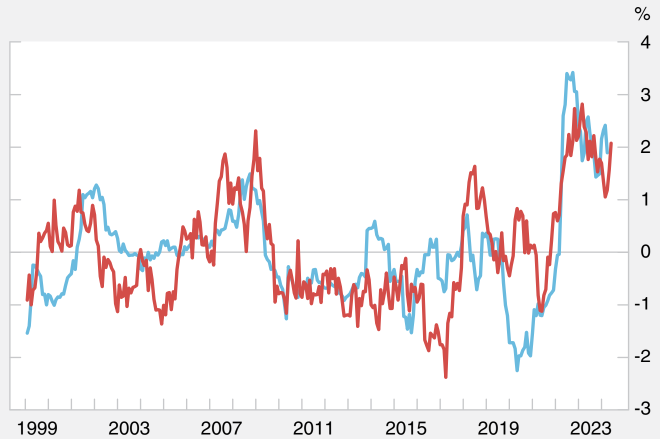
Last observation: June 2024

For a closer look at the underlying inflationary pressures in services excluding shelter, Bank of Canada staff calculated a median inflation rate measure for this category based on the prices of around 10,000 individual services.[2] This rate is still elevated relative to normal, suggesting underlying inflationary pressures remain (**Chart 4-C**).

2 This rate is the weighted median of all non-zero inflation rates across services excluding shelter components in the consumer price index (CPI) microdata. For more information on this dataset, see O. Bilyk, M. Khan and O. Kostyshyna, "Pricing behaviour and inflation during the COVID-19 pandemic: Insights from consumer prices microdata," Staff Analytical Note No. 2024-6 (April 2024). A key advantage of this measure is that it is less sensitive to influence from individual outliers, such as communications prices in the recent CPI data.

Chart 4-C: Wage growth is correlated with inflation in some services prices

Year-over-year percentage change, demeaned and standardized monthly data



Note: LFS is the Labour Force Survey. Series are standardized by subtracting the mean and dividing by the standard deviation.

Sources: Statistics Canada and Bank of Canada calculations

Last observations: wage growth, June 2024; inflation, April 2024

Microdata from the Labour Force Survey (LFS) also suggest that elevated growth in labour costs may have been putting upward pressure on inflation. The median inflation rate of services excluding shelter and the measure of wage growth based on the microdata are shown in **Chart 4-C**.[3] There is a clear correlation between the two series. While this measure of wage growth has been volatile, it has fallen from its peak. This suggests that inflation in services excluding shelter will moderate if wage growth continues to ease.

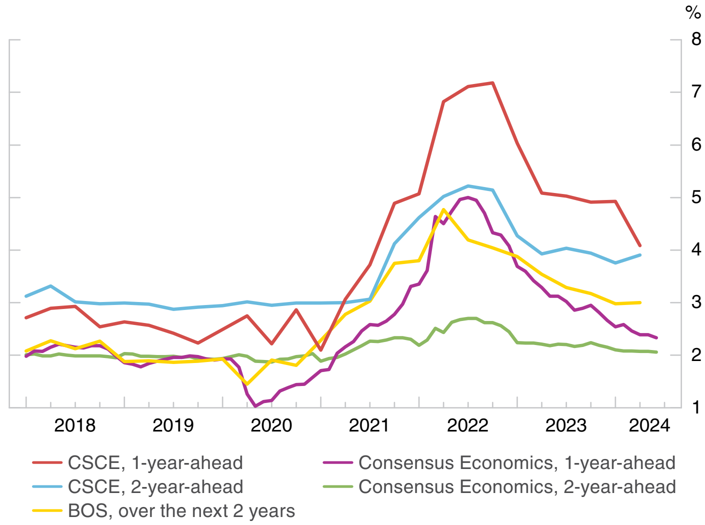
3 This measure of wage growth uses the LFS microdata to abstract from changes in worker characteristics, extracting a quality-adjusted price for labour. For more details, see F. Bounajm, G. Galassi and T. Devakos, "Beyond the averages: Measuring underlying wage growth using LFS microdata," Bank of Canada Staff Analytical Note (forthcoming).

Inflation in services prices excluding shelter rose to 2.9% in June 2024, close to its historical average, after having been below 2% for most of the year. The pickup is due to slower price declines across a few components, particularly communications. This has more than offset the easing of inflation in other components, such as food services.

Measures of core inflation were around 2¾% in June 2024, down from about 3.5% at the end 2023.

Chart 10: Most measures of near-term inflation expectations have continued to come down

Quarterly and monthly data



Note: CSCE is the Canadian Survey of Consumer Expectations; BOS is the Business Outlook Survey. Consensus Economics' forecasts for the next year (based on monthly data) and the next two years (based on a combination of monthly and quarterly data releases) are transformed into fixed-horizon forecasts by the weighted average of fixed-date forecasts. *1-year-ahead* refers to inflation expectations for the next 12 months. *2-year-ahead* refers to inflation expectations for the period 13 to 24 months from now.

Sources: Consensus Economics, Bank of Canada and Bank of Canada calculations

Last observations: Consensus Economics, June 2024; CSCE and BOS, 2024Q2

Near-term inflation expectations have generally been falling but remain elevated relative to historical levels (**Chart 10**). Household inflation expectations fell sharply in the second quarter after having stalled for close to one year. Businesses' pricing behaviour has largely returned to normal.

Excess supply gradually absorbed

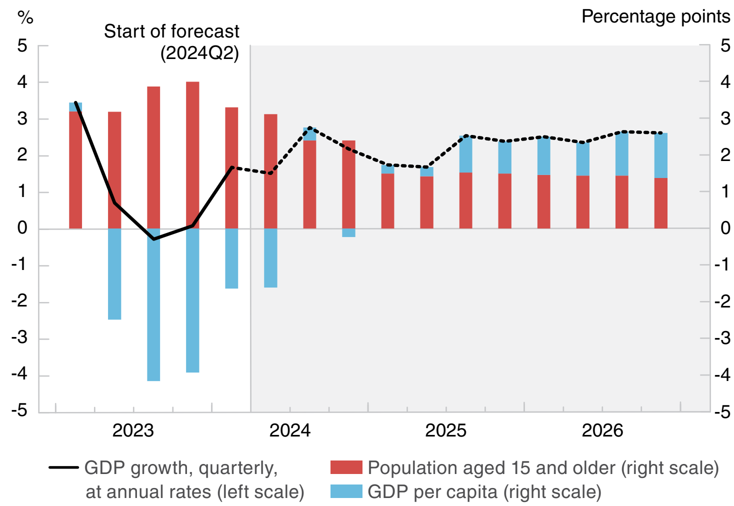
GDP growth is anticipated to strengthen from about 1½% in the first half of 2024 to roughly 2½% in the second half. This increase is largely driven by exports, particularly in energy and motor vehicles, and some pickup in household spending. In contrast, potential output growth is expected to moderate from 2½% to 1½% over the same period, driven by slowing population growth. With supply growth falling below demand growth, excess supply is expected to begin to shrink in the second half of 2024.

Excess supply should continue diminishing gradually over the projection horizon as GDP growth steadily outpaces potential output growth.

- GDP is forecast to expand around 2¼% over 2025 and 2026 (**Chart 11**). Growth is led by consumption and housing, reflecting an increase in household spending per person.
- Potential output is anticipated to expand by a more modest 2% over this period. An assumed pickup in trend labour productivity growth partly offsets the negative impact coming from the expected slowdown in population growth. Trend labour productivity growth turns positive in the first quarter of 2025 and rises to 1% by the end of 2026.

Chart 11: Growth of GDP per capita is expected to strengthen

Contribution to real GDP growth, quarterly data



Note: Data for the population aged 15 and older are from Statistics Canada's quarterly estimates of the population.

Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

Consumption growth strengthens

Despite slowing population growth, the pace of consumption spending is expected to average around 1½% into the first half of 2025. It then rises to 2¼% in the second half of 2025 and stabilizes thereafter. Consumption per person is expected to strengthen as lower interest rates ease debt payments for some households and consumer confidence improves.

However, this outlook is subject to considerable uncertainty given the very different experiences households face. For example:

- Some households are seeing income gains from higher interest rates on investments such as guaranteed investment certificates.
- Some may start to see lower debt payments as interest rates decrease.
- Some will face large increases in debt payments as longer-term mortgage rates reset at higher rates.
- Some variable-rate mortgage holders with fixed payments will have to deal with higher principal payments once they reset their amortization schedules.

This diversity of experience makes forecasting the strength of the aggregate rebound difficult.

Tight housing supply

Growth in residential investment is expected to rise to almost 8% on average over 2025. Growth should then moderate to a still-strong 4% by the end of 2026.

- Population growth and the gradual easing of interest rates will boost demand for new construction. Although government programs should help increase supply, structural capacity constraints remain (**Box 3**).
- The high funding costs currently hindering construction are expected to become less binding in the medium to long term as interest rates decline.

- Growth in renovation spending is expected to pick up over the projection horizon due to easing financial conditions and rising income growth.

Robust demand and constrained supply have led to a historically low vacancy rate. This imbalance is expected to hold up house and rental price growth.

Steady expansion of business investment and exports

Business investment growth is expected to average 4¼% over the projection horizon. In the energy sector, additional pipeline capacity is anticipated to lead businesses to increase investment in oil and gas production. Businesses' capital expenditure plans also point to more spending on projects related to electric vehicles and petrochemicals. Over the projection horizon, the increase in investment spending is bolstered by easier financial conditions and the anticipated pickup in economic growth.

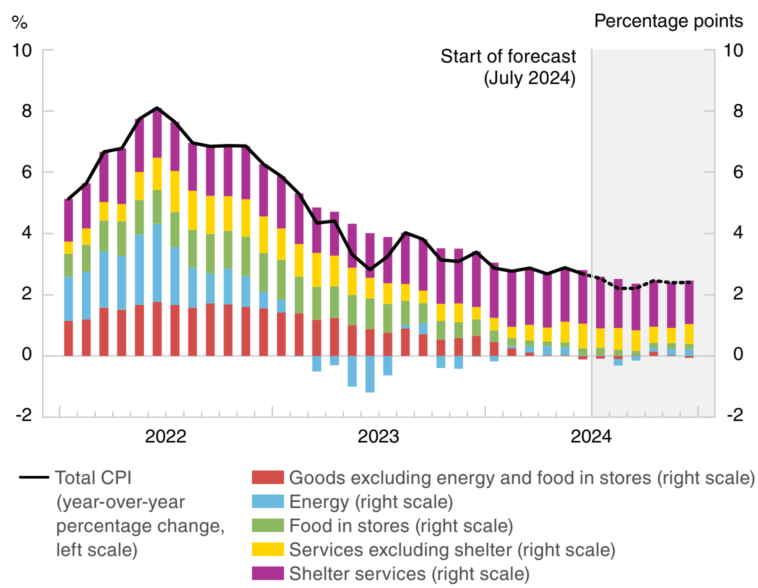
Export growth is expected to rise to 6¼% on average over the second half of 2024. This increase is led by oil exports, as new capacity is created by the Trans Mountain Expansion pipeline. As well, motor vehicle exports should rebound as the drag from plant retooling eases. As the impact from these factors fades, growth is projected to gradually moderate to about 2% by the end of 2025, bringing it in line with the expansion of foreign demand.

Continued progress toward inflation target

Inflation is projected to fall below 2.5% in the second half of 2024 (**Chart 12**). At the same time, core inflation declines more gradually. CPI inflation is temporarily pulled below core inflation largely by base-year effects in gasoline prices.

Chart 12: CPI inflation is expected to fall below 2.5% over the near term

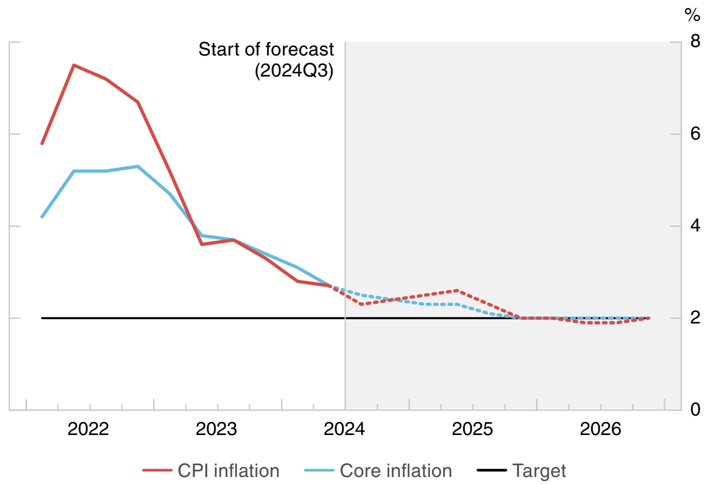
Contribution to CPI inflation, monthly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: December 2024

Chart 13: CPI inflation is forecast to return to target in the second half of 2025

Year-over-year percentage change, quarterly data



Note: Core inflation is the average of CPI-trim and CPI-median.

Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

CPI inflation is then anticipated to rise modestly as the base-year effects from gasoline fade and inflation in some goods prices comes off recent lows (**Chart 13**). Inflation averages around 2½% in the first half of 2025 on the strength of services price inflation.

Shelter price inflation remains elevated due to high mortgage interest costs and rent inflation. However, both are expected to ease somewhat. Price growth in some services remains elevated but is projected to slow as wage growth softens.

Inflation in prices for goods excluding energy remains low, due to modest growth in global demand and weak growth in input costs.

While the trajectory may be bumpy, inflation is anticipated to sustainably reach the 2% target in the second half of 2025. Housing market imbalances and labour cost growth are expected to remain an ongoing source of upward pressure on inflation in shelter prices and services excluding shelter over much of the projection horizon. Moderate excess supply should offset these upward pressures. By the end of the projection, inflationary pressures fade, and the economy returns to balance.

Risks to the inflation outlook

The Bank considers the outlook in the base-case scenario to be the most likely outcome for inflation. There are both upside and downside risks to this outlook. Overall, the Bank views the risks to inflation to be balanced.

The projection for real GDP growth depends heavily on the assumed path for population growth (**Box 2,** page 7). The federal government has announced plans to reduce the number of new non-permanent residents arriving in Canada. However, as highlighted in the April Report, the timing of those changes remains unclear.

The outlook is also subject to increased political uncertainty in many of the world's largest economies. The outcome of recent and future elections may result in shifts in economic policy that could affect the outlook for economic growth and inflation in Canada and around the world.

Main upside risks

There are two broad types of upside risks: services price inflation could be more persistent than in the base case, and global geopolitical developments could renew inflationary pressures.

Services price inflation could persist

Shelter price inflation is expected to remain well above its historical average in the base case. The housing vacancy rate is at a record low as a result of stronger-than-usual population growth and a structural shortage in housing supply. The impact of tight supply could be greater than anticipated, stoking more persistent inflationary pressures.

Inflation in services excluding shelter—while not unusually high—has many components rising at a pace well above their historical average. Recently, larger-than-usual declines in prices for communications have offset this pressure. However, if the pace of these declines was to slow more than expected or if unit labour costs were to remain elevated, inflation in prices for services excluding shelter may not moderate as expected.

Geopolitical developments could fuel renewed inflation

New international trade disruptions stemming from geopolitical tensions and conflicts, including wars in the Middle East and in Ukraine, could impact global commodity prices and impede the supply of traded goods. Attacks on global shipping routes have raised shipping costs to their highest levels since mid-2022. If these disruptions persist or worsen, they could constrain supply and increase producer costs. This would delay the return of inflation back to target.

At the same time, trade tensions have been rising, with restrictions being placed on a widening range of goods and services. This could lead to disruptions of supply chains and trade flows as well as additional tariffs, putting upward pressure on inflation.

Main downside risks

A further slowdown in household spending in Canada and a weaker global economy are the main downside risks to inflation.

Household spending could weaken

Household spending could be weaker than in the base case. More Canadians will face higher debt-servicing costs due to upcoming mortgage renewals. Households could become more cautious and, in turn, cut back on consumption spending by more than projected, particularly if labour market conditions turn out to be weaker. Survey responses have recently reflected greater cautiousness, with households in the Bank's Canadian Survey of Consumer Expectations increasingly concerned about layoffs.

Slower demand growth could, in turn, make Canadian businesses less willing to invest or to hire new workers. With the economy already in excess supply, additional weakness would put more downward pressure on inflation.

Global activity could weaken

Global activity could be weaker than in the base case. The impact of past increases in interest rates in advanced economies may be greater and more persistent than expected. In China, high debt levels and challenges with managing credit risk may further soften lending and growth. Slower-than-expected global growth could also lead to a repricing of risk in financial markets. The resulting fall in equity prices and wider credit spreads would amplify the economic weakness.

As a result, prices for commodities and the demand for Canadian exports would suffer. Canadian economic growth and inflation would be pulled down if these risks were to materialize.